# IFRS in Focus
## IASB proposes amendments to IAS 1 regarding the classification of liabilities with covenants

Contents



This *IFRS in Focus* outlines the proposals included in Exposure Draft ED/2021/9 *Non-current Liabilities with Covenants (Proposed amendments to IAS 1)*, published by the International Accounting Standards Board (Board) in November 2021.

- The Board proposes to amend IAS 1 to specify that conditions an entity must comply with in the twelve months after the reporting period do not affect classification of the corresponding liability as current or non-current
- An entity would present separately in its statement of financial position non-current liabilities subject to such conditions, using a description that indicates that the non-current classification is subject to compliance with conditions within twelve months after the reporting date
- It would also be required to explain in the notes the conditions an entity is required to comply with, whether it would have complied with the conditions based on the circumstances at the end of the reporting date, and whether and how the entity expects to comply with the conditions after the reporting period
- The amendments would be applied retrospectively (applying IAS 8) and the effective date would not be before 1 January 2024. Earlier application is proposed to be permitted
- The comment period for the ED ends on 21 March 2022

### Background
IAS 1 *Presentation of Financial Statements* requires that, for an entity to classify a liability as non-current, the entity must have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.

In 2020, the Board issued amendments to IAS 1 titled *Classification of Liabilities as Current or Non-current*. In the amendments, the Board specified how an entity assesses whether it has the right to defer settlement of a liability when that right is subject to compliance with specified conditions (often referred to as 'covenants') within twelve months after the reporting period.

Stakeholders have since asked whether an entity could classify a liability as non-current if it does not comply with covenants at the end of the reporting period, even if compliance with these covenants is only required within twelve months after the reporting period. The Board decided to address these stakeholder concerns.

### The proposed amendments
The proposed amendments would specify that a covenant affects the entity's right to defer settlement of a liability for at least twelve months after the reporting date (and therefore must be considered in assessing the classification of the liability as current or non-current) if the entity is required to comply with the covenant on or before the end of the reporting period. This is the case even if compliance with the covenant is assessed only after the reporting date (e.g. a covenant based on the entity's financial position at the reporting date that is assessed for compliance only after the reporting date).

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It is also proposed to specify that the right to defer settlement is not affected if an entity only has to comply with a covenant in the twelve months after the reporting period. The ED indicates that when an entity classifies liabilities subject to such covenants as non-current, those liabilities are presented separately in the statement of financial position. The separate presentation must include a description which indicates that the presentation as non-current is subject to compliance with covenants within twelve months after the reporting period.

In addition, an entity would be required to disclose information in the notes that enables users of financial statements to assess the risk of the liability becoming repayable within twelve months. Particularly, an entity would explain the covenants with which the entity is required to comply, whether it would have complied with them based on its circumstances at the end of the reporting period and whether and how the entity expects to comply with them after the end of the reporting period.

**Observation**

Two Board members disagreed with the publication of the ED as they did not agree with the proposed separate presentation of liabilities that are classified as non-current subject to compliance with covenants. In their view, a separate presentation contradicts the principles-based approach in IFRS Standards. It would be sufficient to identify those liabilities through disclosure in the notes, complemented by the disaggregation requirements already included in IAS 1.

They also disagreed with the disclosure of whether and how an entity expects to comply with the covenants within the twelve months after the reporting period. This is because an entity should not be required to provide forward-looking information in that respect. Users of financial statements should be capable to assess the risk of the liability becoming repayable within twelve months without this disclosure, for example by using the provided explanation of the covenants together with the current and past reports and additional economic information.

Furthermore, the Board proposes to specify that an entity does not have the right to defer settlement if the liability could become repayable within twelve months after the reporting period and this is either at the discretion of the counterparty or a third party, or conditional on an uncertain future event whose occurrence is unaffected by the entity's future action (for example, a financial guarantee or insurance contract liability). The ED notes that in such situations, the right to defer settlement is not subject to a condition with which the entity must comply.

**Observation**

BC19 of the ED indicates that when a liability could become repayable within twelve months either at the discretion of the counterparty or a third party or conditional on an uncertain future event whose occurrence is unaffected by the entity's future action, there are no conditions with which the entity must comply in order to avoid settlement of a liability within twelve months after the reporting date. The paragraph concludes that accordingly, those situations are not within the scope of the proposed amendments.

## Transition, effective date and comment period

The ED proposes retrospective application of the amendments, applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The Board does not propose an effective date but specifies that the amendments would not apply before 1 January 2024. Earlier application is proposed to be permitted.

At the same time, it is proposed to align the effective date of the 2020 amendments to IAS 1 *(Classification of Liabilities as Current or Non-current)* to the effective date of the proposed amendments. The 2020 amendments would otherwise have applied from 1 January 2023. This is to avoid that entities would have to assess the classification of their liabilities twice in a short time period.

The comment period for the ED ends on 21 March 2022.

## Further information

If you have any questions about the classification of liabilities with covenants, please speak to your usual Deloitte contact or get in touch with a contact identified in this *IFRS in Focus.*

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